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TREASURY FOR SGOOCH  
NSC FOR DTOMLINSON

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SUBJECT: ECUADOR'S COMPLEX MILITARY-INDUSTRIAL DIVESTMENT

Classified By: Deputy Chief of Mission Jefferson T. Brown for Reasons 1  
.4(b) and (d)

CONFIDENTIAL

¶1. (C) Summary: In a January 22 meeting with DATT and EconOff, senior managers of HoldingDINE, one of Ecuador's military-industrial conglomerates, expressed confidence that they would continue to enjoy freedom of operation even as a newly ratified law aims to impose strict limitations on the military's participation in the Ecuadorian economy. As part of their response to the new law, HoldingDINE's managers are developing an ambitious new plan that justifies and extends the military's moneymaking enterprises as essential for financial maintenance of the armed forces and for developing frontier projects to prevent expansion of illicit crop cultivation across the Ecuadorian border. End comment.

ECUADOR'S MILITARY COMPANIES

¶2. (C) On January 22, DATT and EconOff met with Colonel Nelson Echeverria and Colonel (ret.) Eduardo Acosta, President and Chief Strategist, respectively, of the Direccion de Industrias del Ejercito (HoldingDINE), to assess their plans in the wake of this month's ratification of Ecuadorian law 2007-74, the "Organic Law for National Defense." Among other provisions, this law states that in terms of Ecuador's social and economic development, the armed forces (FFAA) "will be permitted to participate in economic activities related exclusively to national defense." The law also states that "the use of FFAA personnel and property in private sector activities is prohibited."

¶3. (U) Media exposes began to appear in the Ecuadorian press as this bill was in debate in the congress. In late September, Ecuadorian daily El Comercio reported that then Minister of Defense Jarrin had ordered the liquidation of nineteen military-owned companies and the divestment of five more. The same paper reported in early January that the new Minister of Defense Guadalupe Larriva (who died in a helicopter crash on January 24) estimated that of the FFAA's \$700 million dollar budget, approximately 18% came from military enterprises. According to El Comercio, the new Minister had been advised by some military representatives that the decision to force the FFAA to divest of its economic activities "would generate a serious disequilibrium in the

FFAA budget."

14. (C) HoldingDINE is under the Army branch of the FFAA. Echeverria said that the company contributes approximately \$11 million annually to the Army's coffers, in addition to the value of the military goods like ammunition and uniforms that it transfers directly. He said that compared to the two other major military companies -- national air carrier TAME, owned by the Air Force, and marine fuel transporter FLOPEC, owned by the Navy -- HoldingDINE's total dollar contribution is much smaller. HoldingDINE is the majority owner or minority shareholder in eighteen companies operating in sectors ranging from defense-oriented (steel, munitions, explosives, military uniforms and boots) to the more diversified (food production, flower exports, hotels). Echeverria said that HoldingDINE's market participation in non-defense sectors was "marginal." Its explosives company Explocen, for instance, has a 90.75% market-share, and its munitions company Santa Barbara a 51.29% share, while its dairy producer Aychapicho has .06% market-share and Proteas, a flower exporter, has .04%. Echeverria said that HoldingDINE's profits reached \$24 million last year. He said that HoldingDINE worked with private-sector partners in most of their enterprises; U.S.-based Austin Powder, for instance, is a partner in Explocen, and General Motors is the majority partner in Omnibus BB. HoldingDINE's total portfolio is as follows:

Companies with HoldingDINE Majority Ownership:

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-- Acerias Nacionales del Ecuador (ANDEC); Sector: Steel production; Ownership: 93.29%; Market Share: 23.3%  
-- Explocen; Sector: Explosives production; Ownership: 60%; Market Share: 90.75%  
-- Complejo Industrial HoldingDINE; Uniforms and boots; Ownership: 100%; Market Share: 1.82%  
-- FMSB Santa Barbara; Munitions; Ownership: 100%; Market Share: 51.29%  
-- Aychapacho; Dairy production; Ownership: 100%; Market Share: 0.06%  
-- DINEAgros; Banana production; Ownership: 100%; Market Share: 0.18%  
-- Proteas del Ecuador; Flower production; Ownership: 61.74%; Market Share: 0.02%  
-- Corpsys; Civil engineering / Construction; Ownership: 100%; Market Share: 0.98%  
-- DINEComs; HoldingDINE marketing/sales arm; Ownership: 100%; Market Share: n/a  
-- Sepriv; Security; Ownership: 100%; Market Share: 0.95%

Companies with HoldingDINE Minority Participation:

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-- Alfamedical; Medical insurance; Ownership: 0.47%; Market Share: 0.92%  
-- Amazonas HOT (JW Marriott Hotel); Hospitality; Ownership: 44.68%; Market Share: 3.37%  
-- Inmobiliaria Amazonas; Property; Ownership: 50%; Market Share: 9.55%  
-- Banco General Ruminahui; Banking; Ownership: 12.85%; Market Share: 2.39%  
-- Maresa; Automotive; Ownership: 0.57%; Market Share: 14.38%  
-- Novacero-Aceropaxi; Steel processing; Ownership: 2.08%; Market Share: 10.74%  
-- Omnibus BB; Automotive; Ownership: 34.1%; Market Share: 82.15%  
-- Soccasa; Shrimp farming; Ownership: 42.2%; Market Share: 0.86%

15. (C) In spite of the media fervor, Echeverria insisted that HoldingDINE will not be forced to divest under the new law, but that it "will have to work under a new regulatory framework." According to Echeverria, HoldingDINE is constantly engaging in divestment and restructuring. He said that the Ecuadorian constitution permits "self-management" of military-related enterprises, and more importantly that the Ecuadorian government "does not have the resources to fund"

the FFAA, especially as military budgets are being cut to fund more social spending.

"TOO MUCH TRANSPARENCY"

16. (C) EconOff asked what was behind the recent political impetus for restructuring. Echeverria said that "certain interests" wanted the military out of the private sector not because they were significant competitors in most sectors, nor because they exercise any unfair market advantages that their military status might afford. Indeed, Echeverria said that in operating according to market rules, they "behave better" than their private sector competitors. Echeverria says that divestment is being pushed on them because their operations were "too transparent". Echeverria said that because HoldingDINE's finances are publicly available, including its tax payments, people were starting to use its results as referents for the sectors in which they operate. According to Echeverria, HoldingDINE's larger private sector competitors fear that in the current atmosphere of "transparentization", people will look at military companies' revenues, tax payments and market share and begin to extrapolate what private industry is failing to pay to the state.

17. (C) Echeverria also described HoldingDINE's work in border development projects as becoming a victim of its own success.

He described HoldingDINE as contributing more to border development than any other governmental, non-governmental or private organization, and said that HoldingDINE insisted on accountability and success measurement. This posed a danger, he said, to the dozens of organizations working on development projects and "skimming" money from the financing they receive.

MORE, NOT LESS

18. (C) As a response to calls for divestment, HoldingDINE is proposing a strategy to justify and increase its involvement in Ecuador's economic and social development. This plan, largely devised by Col. Acosta, is called the Program for Support of the Frontier (APODEFRON). APODEFRON is HoldingDINE's answer to the challenge of preventing the spread of illicit crop cultivation across the Ecuadorian border. Post DAO will present details of the initiative in septel, but Acosta's general point was that Ecuador's current geographical position as an island of relative calm amid the world's largest cocaine producers demands that the military be more, not less, involved in business and economic development. He (rightly) observed that the military has an "image of credibility" among the Ecuadorian public, and that only the FFAA has the resources and track-record to develop Ecuador's vulnerable frontiers. HoldingDINE, through its various moneymaking enterprises, was and should continue to be a vital player in this effort.

COMMENT

19. (C) Echeverria and Acosta presented HoldingDINE as the only clean player in Ecuador's notoriously corrupt private sector. Their explanation that they are being pushed out because their transparency makes "business as usual" more difficult for their competitors is clearly not the whole story, but it is just counter-intuitive enough to ring at least partially true in Ecuador's labyrinthine economic society. We will continue to speak with other relevant parties, such as HoldingDINE's automotive partner General Motors, to hear alternate perspectives.

110. (C) Reforms set in motion by former Defense Minister Oswaldo Jarrin, which propose limited divestment, reflect changes we believe are necessary to build a stronger, more efficient military. However, critics of the measure claim that divestment will strain the GOE's ability to fund its

military. While likely true in the short-term, the Ecuadorian military has a top-heavy structure that is more ceremonial than operational. It currently spends an estimated 70% of its budget on salaries and the remaining 30% on operations, leaving inadequate resources for procurement, operations, maintenance and training. Lack of adequate funding for fuel and vehicle and aircraft replacement and repair has limited the military's capacity to meet Ecuador's modern security needs. Post has supported efforts by the military to professionalize and, where appropriate, will encourage efforts to modernize and restructure.

¶11. (C) Post suspects that it will be difficult for the new civilian Minister of Defense (yet to be named) to force the issue, as HoldngDINE's business operations not only relieve the MOD of having to compete against Correa's ambitious social and economic plans, but also provide many opportunities for gainful employment for retired military officers and their relatives and a lucrative post-retirement safety net. Forced divestment pursued by the government would threaten these interests and disrupt the current comfortable status quo. Given the military's pivotal role in the last three irregular changes in government and Correa's looming battle with the Ecuadorian Congress over the constituent assembly, Correa may be forced to move to a back burner any sweeping reforms that might alienate current military leadership and the influential cabal of retired officers. He will probably need their support in the coming months and years and he will be intent on building bridges to the military, not burning them. End comment.

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